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TEXTS AND MISCELLANEOUS

STATUTES

IN THE

Supreme Court of the United States

October Term, 1948

No. .....

CENTRAL INVESTMENT CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable the Supreme Court of the United States:

Your petitioner, Central Investment Corporation, a California corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, affirming a decision of the Tax Court of the United States.

Opinions Below

The Tax Court's opinion [R. 46-59][1] is reported at 9 T. C. 128. The *per curiam* opinion of the Circuit Court of Appeals, affirming the decision of the Tax Court [R. 94], is reported at 167 F. 2d 1000.

[1]References such as this are to pages of the printed Transcript of Record. Italics used in this Petition are added by petitioner unless otherwise indicated.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered May 7, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

Whether, when a State tax statute imposes a franchise tax based upon income and expressly designates the last day of the year on the income of which the tax is based as the time when liability for the tax accrues and a lien for the tax attaches to the property of the taxpayer, the taxpayer is entitled to a deduction under Section 23 (c)(1) of the Internal Revenue Code in the Federal taxable year in which falls such accrual and lien date.

Statutes and Regulations Involved

The statutes and regulations involved are as follows:

Internal Revenue Code, Sections 23 (c)(1), 41, 43, and 48 (c);

Regulations 111, Sections 29.23 (c)-1, 29.41-1, 29.41-2, 29.41-3, 29.43-1, 29.43-2;

California Bank and Corporation Franchise Tax Act[2] (California Statutes, 1929, p. 19, as amended to and in effect on December 31, 1943), Sections 4 (3), 4 (5), 4 (7), 5, 11, 13 (a), 13 (j), 13 (k), 13 (o), and 29.

Said statutes and regulations are set forth in the Appendix hereto.

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[2]Herein sometimes referred to as the Act or the Franchise Tax Act.

The regulations and rulings by the California Franchise Tax Commissioner applicable to the period here involved are not published in any official publication. The applicable portions of such regulations and rulings, as reported in the California Corporation Tax Service (Commerce Clearing House), are set forth in the Appendix hereto.

Statement

Petitioner is a California corporation. It is the owner of the real property known as the Biltmore Hotel in Los Angeles, California. [R. 3, 4-5, 14.] During the period in question petitioner kept its books of account and made and filed its Federal income and excess profits tax returns on the accrual basis (*which basis admittedly clearly reflects its income*), and for the calendar year period. [R. 5, 14.] Petitioner accrued on its books as of December 31, 1943, its liability for the California franchise tax computed on the basis of its net income for 1943. [R. 6.] This was strictly in accordance with the provisions of the California taxing statute, which expressly provided that the franchise tax "shall accrue" on the last day of the income year, i.e., the year the income of which is the base for computing the tax, and "shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the last day of the 'income year' * * *." (Act, Section 4 (7), and 29 (a), as amended by Cal. Stats. 1943, pp. 1404 and 1458.)

Petitioner accordingly claimed, on its Federal income and excess profits tax returns for the calendar year 1943, a deduction in the amount of the liability so accrued for the California franchise tax based upon its 1943 income. [R. 67] Petitioner paid the full amount of the tax so accrued, and no portion thereof has ever been refunded, nor has any claim for refund of any portion thereof ever been filed. [R. 5, 6.] The respondent, however, disallowed this deduction in 1943 upon the ground that such taxes were properly deductible by petitioner under Section 23 (c) of the Internal Revenue Code during the calendar year 1944 only. [R. 12.] The Tax Court upheld the respondent [R. 46-60] and its decision was affirmed by the Circuit Court of Appeals for the Ninth Circuit by a *per curiam* opinion. [R. 94-95.]

Specification of Errors to be Urged

The Circuit Court of Appeals erred:

1. In holding that the amount of $43,174.36, which was the amount of the California franchise tax based upon petitioner's net income for the calendar year 1943, did not accrue on December 31, 1943.

2. In holding that said amount of $43,174.36 was not deductible by petitioner in computing its net income for Federal income and excess profits tax purposes for the calendar year 1943.

3. In failing to reverse the decision of the Tax Court.

Reasons for Granting the Writ

1. GENERAL STATEMENT OF REASONS.

The decision of the Circuit Court of Appeals is in conflict in principle with the decisions of other Circuit Courts of Appeals involving time of deduction of accrued liabilities. It is also in conflict in principle with applicable local decisions as to the validity and effect of accrual and lien provisions in California taxing statutes. The Circuit Court of Appeals has decided Federal questions in a way probably in conflict with applicable decisions of this Court. In the alternative, if the Federal questions so decided have not been settled by this Court, then they are important questions of Federal law which should be settled by this Court.

2. IMPORTANCE OF THE QUESTIONS INVOLVED.

This is the first decision as to the proper accrual date for California franchise taxes under the 1943 amendments. This tax applies, with minor exceptions, to all corporations, foreign as well as California, doing business in this State. It is apparent, then, that the decision is of general importance and not one which affects merely the fortunes of petitioner. Statistics of the office of the Franchise Tax Commissioner of the State of California show the number of corporations filing franchise tax returns, the amount of income reported, and the amount of tax paid under the Franchise Tax Act from 1943 to 1946 were as follows:[3]

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[3]See Statistics of Income, State of California, Franchise Tax Commissioner, as published for 1943, 1944, 1945, and 1946 returns, respectively.

Year	Number of returns filed	Net income reported[4]	Franchise tax paid[5]
1943	25,071	$1,741,929,000	$64,627,686
1944	25,076	1,669,647,000	59,153,785
1945	24,617	1,394,685,000	49,675,876
1946	15,156	1,484,949,000	52,657,505

Respondent, in his argument before the Circuit Court of Appeals, emphasized the importance of the decision to the Federal revenues. Certainly, if the decision had been the other way respondent would undoubtedly have urged upon this Court the importance of the question involved. Finally, in answering the ultimate question which is thus of general importance to all corporations paying the California franchise tax and to the Treasury, questions are presented which, as will be more fully developed in the succeeding paragraphs, are important from the standpoint of the local and Federal law involved.

3. THE DECISION IS IN CONFLICT WITH APPLICABLE LOCAL DECISIONS, DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS, AND DECISIONS OF THIS COURT.

(a) The decision of the Circuit Court of Appeals fails to give effect to the express provisions of the local taxing statute as to the time when liability for the tax accrues and becomes a lien on the property of the taxpayer, and to the local decisions construing the effect of similar provisions. The decision is in conflict with the principle established by the local decisions that a valid and effective

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[4]To nearest thousand dollars.

[5]To nearest dollar.

tax lien may be imposed prior to the time when the tax is assessed or becomes payable. *County of San Diego v. County of Riverside* (1899), 125 Cal. 495. Furthermore, the decision is in conflict with the principle established by the local decisions that when a valid lien exists, there is necessarily a then-existing "liability" which the lien thus imposed is to secure. *East Bay Municipal Utility District v. Garrison* (1923), 191 Cal. 680, 692-693.

(b) The decision of the Circuit Court of Appeals, in failing to give effect to the express provisions of the local taxing statute designating the date when liability for the tax accrues and becomes a lien on the property of the taxpayer, is in conflict with the decision of this Court in *Magruder v. Supplee*, 316 U. S. 394, which petitioner believes establishes the principle that the local taxing statute is controlling in determining the accrual date of such tax for Federal income tax purposes. In this respect, the decision is also in conflict with the decisions of other Circuit Courts of Appeals on the same point. See, for example, *Commissioner v. LeRoy* (C.C.A. 2, 1945), 152 F. 2d 936. If, however, as the respondent contended below, no decision of this Court has as yet settled the principle that the local law is controlling as to the date when liability for the local tax accrues and thus becomes deductible for Federal tax purposes, then the question is an important one which should be settled by this Court.

(c) The decision of the Circuit Court of Appeals is also in conflict with the decisions of this Court in *Magruder v. Supplee, supra, United States v. Anderson*, 269 U. S. 422, and *Dixie Pine Products Co. v. Commissioner*, 320 U. S. 516, as to when "liability" for a tax accrues so as to be deductible under Section 23 (c)(1) of the Internal Revenue Code by a taxpayer filing its

returns on the accrual method. Petitioner believes that the decision of this Court in the *Supplee* case settles the principle that "liability" for a tax arises, and the tax therefore accrues for Federal income tax purposes, in the Federal taxable year in which falls the date on which *personal liability* for the tax arises, or in which a *lien* therefor attaches, whichever is earlier, and that when a local taxing statute expressly designates a single date as the time when liability for the tax accrues and a lien for the tax attaches to the property of the taxpayer, that establishes the year in which the tax is deductible for Federal income tax purposes. Petitioner also believes that the principle established or recognized in the *Anderson* and *Dixie Pine* cases—that a tax accrues in the year in which all of the events have occurred which fix the amount and fact of the taxpayer's "liability"—does not require, or permit the respondent to require, the accrual of a tax at a *later* date than that expressly designated in a local tax statute as the date on which liability for the tax accrues and a lien for the tax attaches to the property of the taxpayer. In the alternative, if the decisions of this Court have not settled the question of the effect, for Federal tax purposes, of an express statutory provision designating the date when liability for a local tax shall accrue and a lien for the tax shall attach to the property of the taxpayer, then this is an important Federal question which should be settled by this Court.

(d) The decision of the Circuit Court of Appeals is in conflict with the decisions of this Court and decisions of other Circuit Courts of Appeals as to what constitute "contingencies" as to liability which will require the postponement of accrual of such liability. The Circuit Court of Appeals upheld the Commissioner in disregarding the

accrual which was in fact made by petitioner as of December 31, 1943, upon the bare ground that under the local law it was, technically, legally possible on that date that events might subsequently occur which would entitle petitioner to an abatement or refund of some part of the tax the liability for which was established and became a lien on December 31, 1943. In so holding the Circuit Court of Appeals disregarded the established distinction between the effect of contingencies which go to the very existence of liability in the first instance (i.e., contingencies which are in the nature of conditions precedent to liability), and the effect of contingencies which merely go to the question of how much, if any, of the liability may be required to be satisfied (i.e., contingencies which are in the nature of conditions subsequent to liability). This is in conflict, in principle, with *Helvering v. Russian Finance & Construction Corp.* (C.C.A. 2, 1935), 77 F. 2d 324.

Further, in so holding the Circuit Court of Appeals disregarded the fact that "all of the events" which are in the nature of conditions precedent to, and which therefore establish *liability* for the franchise tax based on 1943 net income, in the first instance, and which establish the amount thereof, *had occurred* by December 31, 1943. This is in conflict, in principle, with *United States v. Anderson, supra,* and *Dixie Pine Products Co. v. Commissioner, supra,* as correctly interpreted. Petitioner believes that neither the *Anderson* case nor the *Dixie Pine Products* case, *supra,* requires that "events" which are in the nature of conditions subsequent to liability must have occurred before such liability can be accrued and deducted. In the alternative, if the principle has not yet been settled by decision of this Court, that "contingencies" which are in the nature of conditions subsequent to the establishment

of liability for a tax do not postpone the date of accrual of such tax for Federal income tax purposes (except when the facts known at the time of such accrual date show there is a reasonable likelihood of events subsequently occurring which will affect the amount which may be required to be paid on the tax liability), then that is an important Federal question which should be so settled.

(e) The decision of the Circuit Court of Appeals is also in conflict with the decisions of this Court in *United States v. Anderson, supra,* and *Magruder v. Supplee, supra,* in that it interprets the *Anderson* case as holding that a tax must be deducted in the year "for" which it is imposed or to which it is "attributable," and that such requirement is controlling even if there is an express provision in the local statute designating an earlier date as the time when liability for the tax shall arise and a lien therefor attach to all of the property of the taxpayer. The decision is also, in any event, in conflict with the *Anderson* case, in determining that the 1943 franchise tax is "attributable" to 1944, the year "for" which, in a technical sense only, it is imposed, rather than to 1943, on the income of which it is a real economic burden and charge.

In the alternative, if it has not yet been settled by decision of this Court that a tax accrues on the date on which "liability" therefor arises under the controlling provisions of the local law, even if such date is not in the year "for" which the tax is imposed, this is an important question which should be settled by decision of this Court. Also, if it has not yet been settled by decision of this Court that a state legislature, in imposing a franchise tax based upon income, may establish a date when liability for the tax arises which is in a year other than the year

"for" which the tax is imposed, then this is likewise an important Federal question that should be settled by decision of this Court. Finally, if it is the law that a state legislature cannot specifically provide that liability for a franchise tax based upon income shall arise on the last day of the year on the income of which the tax is based, so as to make it possible for corporations paying such tax to accrue and deduct it in the year on the income of which it is a real economic burden or charge rather than in the year to which it is in a technical legal sense, only, "attributable," then this is a point which should be settled by decision of this Court.

(f) The decision of the Circuit Court of Appeals is in conflict with the decisions of this Court and with the decisions of other Circuit Courts of Appeals as to the effect of Sections 41 and 43 of the Internal Revenue Code under the facts herein.

Section 41 is inapplicable in the present case because the pleadings admit that petitioner kept its books and filed its returns "on the accrual basis, which basis clearly reflects its income." [R. 5, 14.] Section 43 was not intended to authorize the Commissioner to take deductions out of the year in which they in fact legally accrued and allow them only in some other year. See *Security Flour Mills Co. v. Commissioner,* 321 U. S. 281, and *Dixie Pine Products Co. v. Commissioner, supra.*

The determination of the Commissioner in the present case is the result of his patent disregard of the express provisions of the controlling local law as to when liability

for the franchise tax accrues and a lien therefor attaches to the property of the taxpayer. This is not the exercise of discretion, but the application of an entirely erroneous principle.

In the alternative, if the principle that Section 43 does not authorize the Commissioner to disregard the date of accrual of a tax as shown by express provisions in the local tax statute has not yet been settled by any decision of this Court, then that is an important question which should be so settled.

Conclusion.

For the foregoing reasons and for the reasons set forth in the brief in support of this petition, presented herewith, the petition for a writ of certiorari should be granted.

Respectfully submitted,

JOSEPH D. BRADY,
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c/o Brady & Nossaman,
433 South Spring Street,
Los Angeles 13, California,
Counsel for Petitioner.

Certificate of Counsel

We, the undersigned, Joseph D. Brady and John O. Paulston, counsel for petitioner herein, hereby certify that in our judgment and opinion the foregoing petition for a Writ of Certiorari is well founded, and that it is not interposed for purpose of delay.

JOSEPH D. BRADY,
JOHN O. PAULSTON.

IN THE

Supreme Court of the United States

October Term 1948

No.....

CENTRAL INVESTMENT CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

The statements in the Petition for a Writ of Certiorari, presented herewith, in regard to the "Opinions Below," "Jurisdiction," "Questions Presented," "Statutes and Regulations Involved," "Statement of the Case," and "Specification of Errors," are incorporated herein by reference.

Summary of Petitioner's Argument

A clear question of law is presented.

Section 23 (c)(1) of the Internal Revenue Code provides for a deduction of taxes "paid or accrued within the taxable year * * *." Whether state taxes have "accrued within the taxable year" must be determined by the provisions of the state taxing statute.

Under the express provisions of the California Bank and Corporation Franchise Tax Act, liability for the franchise tax imposed thereby arose, and a lien therefor attached to the real property of the taxpayer, on the last day of the year the income of which formed the basis for the tax. Pursuant to these provisions, petitioner properly accrued on its books of account on December 31, 1943, its liability for the California franchise tax based upon its 1943 net income, and deducted the amount so accrued in its Federal excess profits tax return for its calendar year 1943.

The Circuit Court of Appeals erred in disregarding the controlling state law and in holding that petitioner was not entitled to the deduction claimed, in 1943, upon the alleged grounds that liability for the franchise tax did not arise until 1944, the year "for" which the tax was imposed, and in holding that the tax was required to be deducted in 1944 in order "to properly reflect" petitioner's net income.

ARGUMENT

I.

Repeal of the Dobson Rule.

Inasmuch as the rule established by *Dobson v. Commissioner* (1943), 320 U. S. 489, has been eliminated by legislative action (Sec. 36, Pub. Law 773, 80th Congress, 2nd Session, approved June 25, 1948, amending I.R.C. Sec. 1141 (a)), the propriety of the decision by the Circuit Court of Appeals should be considered by this Court on the merits and without regard to the so-called *Dobson* principle.

II.

The Circuit Court of Appeals Erred in Failing to Determine That Petitioner Properly Accrued on Its Books of Account as of December 31, 1943, Its Liability for the California Franchise Tax Based Upon Its 1943 Net Income.

The State Legislature has power to establish the lien and accrual date for taxes imposed by it, at any time chosen by it, even though such designated time is prior to the taking of the necessary steps to fix the amount of the tax, and prior to the commencement of the taxable period *for* which the tax is imposed. And when the accrual and lien date is specified in the taxing statute, this fixes the time when *liability* arises and the *lien* in support thereof attaches. This is true not only as between the taxing entity and the taxpayer, i.e., for the purposes of enforcing payment of the tax by the tax debtor, but is *also* true for the purposes of establishing the respective

priorities as between the taxing agency and other creditors of the taxpayer.

> *United States v. Sampsell* (C.C.A. 9, 1946), 153 F. 2d 731, squarely involving the California Franchise Tax Act as in effect prior to the 1943 amendments.

See, also, *County of San Diego v. County of Riverside* (1899), 125 Cal. 495, and *In re Knox-Powell-Stockton Co.* (C.C.A. 9, 1939), 100 F. 2d 979, both of which cases are cited with approval in the *Sampsell* case, *supra*.

There can be no question that if the statutory provisions designating the last day of the "income year" 1943 as the date for the lien to attach had been before the Court in the *Sampsell* case, and if the United States had had a lien which attached on January 1, 1944, the lien of the State for petitioner's franchise tax based on its 1943 income would have been held superior thereto.

Nevertheless, the Tax Court opinion in the present case, adopted by the Circuit Court of Appeals, states that the accrual and lien provisions of the California Franchise Tax Act "* * * *do not affect the question of accrual for Federal tax purposes*" for the reason that "These provisions of the Act, in our opinion, *only* have significance in terms of priority of liens * * *,"[6] [R. 58; emphasis added.] However, even the Tax Court opinion concedes, in effect, that the provisions of the Act did, at least, "* * * have significance in terms of priority of

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[6]This language has been revised in the official published (but as yet unbound) version of the Opinion [see 9 T. C. 134], to be in the singular, but without changing the effect thereof. The above quotation conforms to the Transcript of Record as cited. Italics used in this Brief are added by petitioner unless otherwise indicated.

liens * * *." [R. 58.] It clearly could not do otherwise in the light of the *Sampsell* and *Knox-Powell-Stockton* decisions, *supra*.

Necessarily, however, to have even *this* effect, there must have been a *liability* to have been *supported by* the lien. See *East Bay Municipal Utility District v. Garrison* (1923), 191 Cal. 680. See, also, *County of San Diego v. County of Riverside*, *supra*.

It is important to note that neither of the courts below expressed any doubt as to the *validity* of the lien in the present case. Nor is there any sound basis upon which they could have questioned the validity of the lien expressly established by the tax statute. Necessarily, then, under the *East Bay Municipal Utility District* case and the *County of San Diego* case, *supra*, there *must* have been a *liability* which the lien thus imposed is to secure; else the lien itself would *not be* valid.

If, then, there was such statutory *liability*, *supported by* a statutory lien having the effect indicated by the *Sampsell* case, petitioner had no alternative but to set up this liability on its books of account as of December 31, 1943. If petitioner had omitted from its accounting statement as of December 31, 1943, its liability for the franchise tax based on its 1943 income, the statement would have been directly contrary to the law and would have presented an entirely erroneous picture of its legal liabilities as of that date to its stockholders, creditors, and others.

The decision of the Circuit Court of Appeals is therefore in conflict with the decisions of the Supreme Court of the State of California and with other decisions by the Circuit Court of Appeals for the Ninth Circuit, in fail-

ing to give effect to the principle that a valid and effective tax lien may be imposed by the taxing statute prior to the time when the tax is assessed or becomes payable, and is also in conflict with decisions of the Supreme Court of the State of California in failing to give effect to the principle that when a valid lien exists there necessarily is a then-existing *liability* which the lien thus imposed is to secure.

III.

The Circuit Court of Appeals Erred in Failing to Determine That Petitioner Was Entitled to a Deduction, in Its Federal Tax Return for 1943, for the California Franchise Tax Which It Accrued on Its Books on December 31, 1943, on the Basis of Its 1943 Net Income.

A. The Circuit Court of Appeals Erred in Disregarding the Rule That Local Law Is Controlling as to When a Local Tax "Accrues" for Purposes of a Deduction Under the Internal Revenue Code.

Section 23 (c)(1) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions, taxes "paid or accrued" within the Federal taxable year (with the exception of certain types of taxes not here involved). It is established by decision of this Court that the question as to when local taxes "accrue," for purposes of this provision, must be determined by a reference to the provisions of the local taxing statute. See *Magruder v. Supplee* (1942), 316 U. S. 394. See, also, Randolph Paul, Selected Studies in Federal Taxation, Second Series (p. 23), where it is pointed out that the Federal statute, by "necessary implication," makes the state law controlling. The author says, further, that "It

is *impossible* to determine when taxes accrue *except* by reference to the local acts imposing the taxes." (*Id.*, p. 24; emphasis added.) See also *Commissioner v. LeRoy* (C. C. A. 2, 1945), 152 F. (2d) 936.

In the present case, however, the Tax Court and Circuit Court of Appeals apparently accepted the view of the respondent that there was or should be some sort of universal rule for fixing the accrual date for *all state franchise taxes*, regardless of what the controlling local law may expressly provide as to the date on which the liability accrues and on which a lien therefor attaches.

The decision of the Circuit Court of Appeals is therefore in conflict with the principle settled by the *Supplee* case that the provisions of the local tax statute are controlling in determining when liability for the tax accrues.

B. The Circuit Court of Appeals Erred in Disregarding the Rule That Where There Is a Specific Accrual and Lien Date in a Tax Statute, That Date Controls as the Accrual Date for Federal Tax Purposes.

The question remains as to how the "accrual" date is to be identified under the local law. The ultimate problem, it is submitted, is to determine when *"liability" for the tax arises under the statute*. Where, as here, the statute specifies a *single* date as the date when liability for the tax shall arise[7] *and a* lien in support of such liability shall attach to all of the real property of the taxpayer, there can be no question but that *that* is the "accrual"

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[7]The statute says "shall accrue," but it is evident that this term is used as being synonymous with the creation of "liability," and this is fortified by the fact that the statute establishes a *lien* for the tax on the same date, which necessarily presupposes an existing "liability."

date for purposes of determining when the deduction allowed by Section 23 (c)(1) of the Internal Revenue Code must be taken.

There are innumerable cases which could be cited upon the foregoing propositions. It is sufficient, however, to refer to the leading decision of this Court, and to certain cases applying the same principle to California taxes.

Magruder v. Supplee (1942), 316 U. S. 394;

California Sanitary Co., Ltd. (1935), 32 B.T.A. 122;

Crown-Zellerbach Corp. (1941), 43 B.T.A. 541 (App. by Commissioner to C.C.A. 9, dismissed on stipulation, 6-29-42, 30 A.F.T.R. 1630).

These cases clearly establish or recognize the principle that taxes "accrue," for Federal income tax purposes, in the Federal taxable year in which falls the date on which personal liability for the tax arises, or in which a lien therefor attaches, whichever is earlier. They also show that this principle applies regardless of whether the tax in question is imposed *for* a taxable period which falls in a *subsequent* Federal taxable period, and regardless of whether, at such accrual date, the *amount* of the tax is due and payable, or is fixed and assessed, or is even *ascertainable* on the basis of facts then known. They thus provide the controlling principles for a decision herein.

The Tax Court opinion in the present case, adopted by the Circuit Court of Appeals, rejected the above-cited decisions for the reason that they "* * * involve generally the question of *who* was liable for local property taxes *as between transferor and transferee.*" [9 T. C. 132; R. 53; emphasis added.] It is true that the first two—but only the first two—of the cited cases (*Magruder*

v. Supplee and *California Sanitary Company, Ltd., supra*) did involve the question of who was entitled to a deduction, for Federal tax purposes, of property taxes paid by a person who purchased the property and paid taxes which became a lien before the date of purchase. It is not apparent, however, why this prevents the principle established therein from being applicable to cases involving the deduction of taxes where no transfer of property is involved.

In the cases involving the right of a *purchaser* to deduct the property taxes paid by him, the courts, although ultimately deciding the question of *who was liable* for the taxes as between transferor and transferee, are also necessarily determining *when liability for the tax accrued.* If the tax accrues on the lien date for purposes of determining *who* is entitled to a deduction therefor as between the seller and the purchaser, it must also accrue on the lien date for purposes of determining *when* it is deductible by a taxpayer on the accrual basis, even if no transfer of the property is involved. In fact, it is squarely so held in the *Crown-Zellerbach* case, *supra,* notwithstanding the Tax Court opinion has lumped that decision with *Magruder v. Supplee* and *California Sanitary Co., Ltd., supra,* in distinguishing all of said cases from the case at bar upon the bare ground that these cited cases "involve generally the question of *who* was liable for local property taxes as between transferor and transferee." Clearly, the decision of the Circuit Court of Appeals is in conflict with the principles established by this Court in the *Supplee* case.

The Tax Court opinion, adopted by the Circuit Court of Appeals, further attempts to distinguish the above-cited "property tax cases"—holding that property taxes

accrue when a *lien* therefor attaches—upon the ground that "The nature and character of the franchise tax herein is essentially different from the property taxes involved in the above discussed cases." [9 T. C. 132; R. 54-55.] Of course, it is true that the two types of taxes differ in many respects. But the question is *not* whether the *taxes* involved in the cited cases are similar in their nature to those involved herein. Rather, it is whether the *statutory provisions identifying the date when "liability" for the taxes arises* are similar. For the ultimate question with which we are concerned—and this must be borne in mind at all times—is, When did *liability* arise? And when, as in the California Franchise Tax Act, the taxing statute expressly designates a single date as the date when liability for the tax accrues *and* when the lien in support of such liability attaches to the property of the taxpayer, *that date is controlling* in determining when "liability" for the tax accrues for Federal income tax purposes.

This is necessarily true regardless of the "nature" of the tax. *Otherwise, full effect is not being given to the provisions of the controlling local law.* Whatever may be the propriety of looking to the "nature and character" of the tax to determine when "liability" arises under a statute which does *not* expressly designate a date when liability arises and when a lien in support thereof attaches, *this is not such a case.*

The Circuit Court of Appeals, in affirming the Tax Court, is therefore in conflict with the decision of this Court in the *Supplee* case, *supra,* in disregarding the express lien and accrual provisions of the tax statute in favor of its interpretation of the general nature of the tax.

C. The Circuit Court of Appeals Erred in Disregarding the Statutory Accrual and Lien Date Because of Alleged "Contingencies" as to Liability for, or Amount of, the Franchise Tax on the Last Day of the Income Year.

In discussing the nature of the franchise tax involved herein, the Tax Court Opinion, adopted by the Circuit Court of Appeals, states that under the terms of the Act withdrawal or dissolution may relieve the taxpayer from taxation for the portion of the "taxable year" during which the franchise privilege is not exercised. [9 T. C. 133, R. 55.] Throughout its opinion the Tax Court places great emphasis upon this alleged "contingency" affecting the amount of the tax which may ultimately be required to be paid. It is submitted, however, that the Tax Court and the Circuit Court of Appeals have misinterpreted the Act in regard to the existence and extent of the alleged "contingency" here involved, and also, and in any event, have misconstrued the power of the Tax Court to disallow a deduction upon the ground that the liability involved is subject to a "contingency." Each of these errors will be separately considered.

(1) Extent of the Right, Under the California Franchise Tax Act, to a Refund in the Event of Dissolution During the "Taxable Year."

The Tax Court Opinion states that if *no* business operations were carried on by the taxpayer in the "taxable" year "the tax would not be imposed." [9 T. C. 133, R. 55.] This clearly is not a correct reading of the California law. The Franchise Tax Act unequivocally provides that *every* corporation shall pay a certain minimum annual tax. This is not only expressly stated at two separate points in the section of the Act imposing the

tax (Act, sec. 4(3) and (5); Appendix, p. 43), but is repeated in the section providing for a refund of a proportionate part of the tax in the event of a withdrawal or dissolution before the end of the "taxable" year. (Act, sec. 13(k); Appendix, p. 46. See also the Franchise Tax Commissioner's interpretation in his Regulation Art. 29-1, paragraph 2. (Cal. C.T. par. 8-053, Appendix, p. 48.) Respondent's unrestrained and constant repetition of his proposition that there would be no liability if no business were done in the taxable year apparently misled the Tax Court, but does not change the law. Here, the *maximum* possible effect of the happening of the "contingency" in the California statute, viz., dissolution or withdrawal in 1944, would be to enable the corporation to reduce, but not eliminate, the tax based on the income of the "income year" which it would otherwise be required to pay.

(2) Extent of Tax Court Power to Disallow a Tax Deduction as Being Only a Contingent Liability.

It is not conceded, however, that the Tax Court and the Circuit Court of Appeals have applied the proper *principle* as to "accruals," even if it were assumed, for the purpose of argument, that their interpretation of the *effect of the state law,* in the foregoing respect, were correct. The following argument is therefore presented as being equally applicable under *either* interpretation of the state law, i.e., regardless of whether the "contingency" specified in the state law may result in a refund or abatement of the entire tax based upon the net income of the "income year," or may, at most, result in a refund or abatement of a part only of said tax.

The principles in regard to the accrual of "contingent" liabilities which must be borne in mind in considering the present case may be summarized as follows:

(1) If at the close of the Federal taxable year the very existence of "liability" is contingent upon the happening of events which have not yet occurred, accrual is not proper on the basis of the facts then known. Such a contingency is in the nature of a condition precedent to the liability. Accordingly, the non-occurrence of such a contingency leaves a status of "non-liability."

(2) On the other hand, if at the close of the Federal taxable year "liability" does exist, but the question of how much, if any, of the liability may be required to be *satisfied* may be affected by subsequent events, then accrual *is* proper *if*, on the basis of the facts then known, the taxpayer has reasonable grounds to believe that his liability must eventually be fulfilled. The contingency in regard to the amount which will be required to be paid is, in such a case, in the nature of a condition subsequent. The propriety of the accrual must necessarily depend upon the likelihood of the condition occurring to *defeat* the status of "liability" which would otherwise exist.

The foregoing distinction between contingencies which affect the very existence of liability and those which merely affect the question of how much of the liability may ultimately be required to be satisfied is well stated in *Helvering v. Russian Finance & Construction Corp.* (C.C.A. 2, 1935), 77 F. 2d 324. In a special ruling issued since the decision in the present case by the Circuit Court of Appeals (amplifying and applying his ruling in G.C.M. 25261, 1947-2 C.B. 44), respondent himself has cited and followed the *Russian Finance* case in support of the conclusion that vacation pay should be accrued in the

year in which *liability* therefor arose, notwithstanding uncertainties as to the *amount* which ultimately would be required to be paid. See Prentice-Hall 1948 Federal Tax Service, ¶76,294, and Commerce Clearing House 1948 Standard Federal Tax Reports, ¶6158. Also, by his acquiescence (1947-2 C.B. 1) in the decision in *The Baltimore Transfer Co. of Baltimore City*, 8 T. C. 1, respondent has recognized that tax accruals are to be determined on the basis of facts known at the close of the taxable year, and if "liability" is then established, the mere fact that subsequent events may give rise to a *refund* does not require postponement of the accrual.

The case of *United States v. Anderson*, 269 U. S. 422, strongly relied upon by the respondent and by the opinion of the Tax Court, does not establish any different principle to be applied in regard to the accrual of liability for taxes. In fact, to the extent to which it is applicable in the present case, that decision favors petitioner rather than respondent.

It is true that in the *Anderson* case this Court established or recognized the principle that a tax may accrue in advance of the assessment thereof if "all of the events * * * which fix the amount of the tax and determine the liability of the taxpayer to pay it" have occurred at an earlier date. (269 U. S. 422, 441.) See also *Dixie Pine Products Co. v. Commissioner* (1944), 320 U. S. 516. However, in applying this principle it has never been considered by this Court that absolute certainty is necessary as to the *amount* which will ultimately be *paid*. All that is required is that the amount and fact of the "liability" be established. See *Continental Tie & Lumber Co. v. United States*, 286 U. S. 290. See also discussion in *Lucas v. American Code Co.*, 280 U. S. 445. This

principle is now also accepted by the Tax Court in *The Baltimore Transfer Co., supra,* in which decision respondent has acquiesced. (1947-2 C. B. 1.)

It is submitted that neither the *Anderson* case nor the *Dixie Pine Products Co.* case, *supra,* was intended to establish any different principle than that stated in the *Russian Finance & Construction Corp.* case, *supra.* "The events" referred to in the *Anderson* case and in the *Dixie Pine Products Co.* case, *supra,* are events which are conditions *precedent* to *"liability,"* and *not* events *subsequent* to "liability," which may, at most, affect the amount of the liability which will ultimately have to be satisfied by payment.

Under the express terms of the statute here in question, "the events" which establish "liability" for the tax and fix the amount of such liability are (1) the conduct of business during the "income year"; (2) the earning of net income upon that business; (3) the failure to dissolve in the requisite manner by the end of that year. Those events, and those events alone, establish the fact of *liability* and the *amount* of that liability. To say that anything more is required is to misinterpret the *Anderson* case as well as to disregard the unequivocal provisions of the local law. The provisions of the local law as to the effect of certain types of dissolution in the succeeding year are merely conditions subsequent, relating solely to the amount which may be required to be *paid* in order to *discharge* the "liability" which arises on the designated accrual and lien date. Under the Act as it is written, these provisions have no relation whatever to the establishment of "liability" in the first place.

Therefore, even if it were true that petitioner could have obtained an abatement or refund of the *entire* tax

based on its 1943 net income *if* it "did no business" in 1944, it would not follow that there was no "liability" which could be accrued on December 31, 1943.

Furthermore, on the basis of the facts known on December 31, 1943, there was no reasonable likelihood that any contingencies which could reduce the amounts to be paid would actually occur. In fact, quite the contrary is indisputably shown. Thus, on December 31, 1943, petitioner knew that under the express provisions of the Franchise Tax Act its liability had accrued for a tax in an amount equal to 3.4% of its net income. It knew that its real property was, on and after that date, subject to a lien for that tax, which lien is in no important respect different from the lien for property taxes. It knew—or by the time its books were closed for 1943 would know (see *Fawcus Machine Co. v. United States*, 282 U. S. 375)—the precise amount of the tax for which the lien was thus imposed. It knew that it could obtain an abatement or refund of some part of this tax *if* it went out of business and dissolved during 1944. As is admitted by the pleadings, however [R. 5. par. (a), and R. 6, par. (c), admitted at R. 14, par. 5], it had no intention of doing this but expected to continue in business and to pay (and it did pay) the tax at the times required by law. It knew on December 31, 1943, that, under the terms of the Franchise Tax Act, it would have to pay the full amount of the tax based on its 1943 income regardless of the amount of its income in 1944, or even if it sustained a loss in that year. *Spring Valley Water Co., Ltd., v. Johnson* (1935), 7 Cal. App. (2d) 258; hearing denied by California Supreme Court. On the basis of these facts petitioner did in fact accrue its liability for the tax based on its 1943 income, as a liability in 1943, and as a charge against the income on which the tax was based.

The decision of the Circuit Court of Appeals is clearly in conflict with the decision in the *Russian Finance & Construction Corp.* case, *supra*, in failing to recognize and apply the distinction between (1) contingencies as to the existence of liability and (2) contingencies as to the amount which may have to be paid to discharge the liability. It is also in conflict with the decision of this Court in the *Anderson* case, *supra*, in failing to hold that "all of the events" which, under the controlling local law, establish *liability* for the franchise tax based on 1943 net income, and which fix the amount of such liability, had occurred by December 31, 1943.

D. The Circuit Court of Appeals Erred in Disregarding the Statutory Accrual and Lien Date Upon the Ground That the Tax Is "For" or Is "Attributable to" a Subsequent Period.

The Tax Court opinion expresses the view that liability for the franchise tax based on 1943 income could not have accrued in 1943 because the tax is imposed for the privilege of doing business in the "taxable year," that is, 1944. [9 T. C. 133; R. 55] Again, it is stated that the tax must be deducted in 1944 because it is "attributable to the business operations" of 1944 rather than 1943, and that it is, therefore, under *United States v. Anderson, supra*, accruable only in the later year. [*Id.*] This view is, in effect, adopted by the Circuit Court of Appeals.

Apparently the Tax Court was of the view that the *Anderson* case imposed a *double* requirement for the accrual of taxes, viz., (1) that all of the events must have occurred in the Federal taxable year to establish liability for the tax and fix the amount thereof, *and* (2) that the tax must be "for" or "attributable to" the year of accrual.

In fact, this position was squarely asserted by respondent before the Circuit Court of Appeals in seeking the affirmance of the Tax Court decision. It is submitted, however, that, in the first place, the *Anderson* case does not impose any such double requirement, and, secondly, that to the extent that it may be required that a tax be "attributable to" the year of accrual, this requirement is met in the present case.

All that this Court, in the *Anderson* case, *held* in regard to the time for accrual of taxes is that they must be accrued when, in an economic and bookkeeping sense, rather than in a technical legal sense, all of the events have occurred which fix the amount of the tax and determine the "liability" to pay it. True, the Court said, in the *Anderson* case, that the "purpose" of the provisions of the Revenue Act there in question authorizing the use of the accrual method in computing net income was to enable taxpayers to keep their books and make their returns "by charging against income earned during the taxable period, the expenses incurred in and properly *attributable to the process of earning income* during that period * * *." (269 U. S. 422 at 440; emphasis added.) However, when it came to the point of deciding the precise question then before it, viz., when the taxes on the income from munitions sales in 1916 were properly accruable, the Court considered only whether "liability" for the tax had arisen in 1916.

Thus, this Court in effect held, in the *Anderson* case, that *if* all of the events which establish "liability" for a tax and fix the amount thereof *have occurred* in the taxable year, the tax *is* "attributable to" that year, in the sense in which it used that phrase. This Court did *not*, as respondent has contended, and as the Tax Court

apparently considered, decide that, *in addition* to finding such "liability," the tax had to be "for" 1916, the year in which accrual was held to be proper. True, the tax involved in the *Anderson* case *was* "for" 1916, but the Court did not make this a basis for its decision on the issue of when the tax accrued. That this must have been deliberate is evidenced by the fact that this Court has squarely held that taxes accrue when "liability" therefor arises *without regard* to whether they are "for" the period in which such liability arises. *Magruder v. Supplee, supra.* The *Anderson* and *Supplee* cases contain no element of inconsistency if the former is recognized as holding, simply, that taxes accrue in *and* are "attributable to" the year in which *liability* therefor arises.

It is further submitted, however, that even if the *Anderson* case does impose some requirement over and above the requirement that "liability" be established in the year of accrual, such additional requirement is met in the present case. For, if the language used by this Court in the cited case is applied in a realistic manner rather than in a technical legal sense, it is clear that the California franchise tax is *"attributable to the process of earning income"* during the *"income"* year, even though it may not be "for" that year in the sense of being a *privilege* tax for that year.

Thus, the historical background of the California franchise tax discloses beyond doubt that the *only* reason for imposing the tax as a tax for the privilege of doing business, with the amount of the tax *measured by* net income, instead of imposing a tax directly *upon* net income, was to enable the State to conform its scheme of taxation of corporations to a permitted method of taxing

banks without discrimination against the latter but with the inclusion of the income from tax-exempt securities in the base for the tax. *Pacific Company v. Johnson* (1931), 285 U. S. 480, 491-492. In a business and economic sense, however, the *burden* of the tax is precisely the same as though it were a tax *on* income, as in the *Anderson* case. The tax based upon the income of the "income year" is required to be paid regardless of the amount of income from the operation of the business during the "privilege" year. *Spring Valley Water Co., Ltd. v. Johnson* (1935), 7 Cal App. 2d 258; hearing denied by Cailfornia Supreme Court. The tax based upon the income of the "income year" is required to be paid in full regardless of whether the corporation has a "taxable year" of twelve months or of less duration. [Act, Section 13 (o), Appendix 46.] In an economic and business sense, then, it is clear that the tax is "attributable to" and a charge upon *the income upon which it was based.*

This view is directly confirmed by the manner in which Section 403 (a)(4)(B) of the Renegotiation Act (Act of April 28, 1942, P. L. 528, 77th Cong., as amended by Section 701 (b) of the Revenue Act of 1943) and the regulations thereunder (Renegotiation Regulations, Sections 389.1 and 389.5) require taxes such as the California franchise tax to be taken into account. It is there clearly recognized that taxes "measured by" income are in reality a charge upon and are "attributable to" the income upon which they are based.

Therefore, although the tax may be "for" the privilege of doing business in the succeeding year, it is, in the language of the *Anderson* case, only in a "technical legal sense," if at all, that the tax is "attributable to" the

privilege year. Further, in the language of that case (269 U. S. 422, at 440), *petitioner's "true income" for the income year 1943 "could not have been determined" without deducting from its gross income for that year the franchise tax attributable to and based upon the production of that income.* See also *Fawcus Machine Co. v. United States,* 282 U. S. 375, where it is said (p. 378):

> * * * A corporation cannot claim to have accumulated any net income in any year until provision is made for taxes accrued, based on net income for the same year.

Notwithstanding the true economic burden of the tax was as thus stated, the local tax statute, prior to the 1943 amendments, expressly provided that the tax accrued and became a lien on the first day of the "taxable year." On the face of the statute, then, all taxpayers were seemingly "tied" to an accrual and deduction of the tax according to its technical legal aspects rather than according to its real economic burden. And this is the view taken by the Commissioner in his rulings under the earlier statute. See I. T. 2971, XV-1 C.B. 107. Accordingly, the Act was amended in 1943 to establish the accrual and lien date as the last day of the income year rather than the first day of the taxable year, *in order to conform the technical accrual date with the economic realities.*

Thus, even if it were to be assumed that a purely arbitrary accrual and lien date in advance of the period "for" which the tax was imposed would not be controlling for Federal income tax purposes—an assumption which is directly opposed to the decisions giving effect to the arbitrary lien date in property tax cases—it is clear that

in the present case the California Legislature has *not* arbitrarily or capriciously selected an accrual and lien date. Rather, it has abandoned a date which had significance in a technical legal sense only, in favor of a date which makes the establishment of liability for the tax conform to the economic realities in regard to the burden of the tax.

The Tax Court and the Circuit Court of Appeals seek to support their disregard of such a provision of the controlling local law upon the ground that the accrual and lien date are of "no significance" when the tax is "for" or "attributable to" a subsequent period. However, no authority has been found for the proposition that taxes which, under express and unequivocal provisions of the local tax law, accrue and become a lien in one taxable year of the taxpayer, may be shifted by the Commissioner to a later taxable year merely because that is the year *for* which the tax is imposed. Certainly no case cited in the opinion of the Tax Court so holds; and that court apparently recognized this, for, as noted, its whole discussion is based upon the false premise that the accrual and lien provisions of the California Franchise Tax Act may be disregarded as having "no significance" except for purposes of establishing the State's "priority." In this the Tax Court, and, by its adoption of the Tax Court opinion, the Circuit Court of Appeals, clearly erred.

The decision of the Circuit Court of Appeals is in conflict with the decision of this Court in the *Anderson* case, as correctly interpreted.

E. The Decision of the Circuit Court of Appeals, Disregarding the Statutory Accrual and Lien Date, Is Not Required or Supported by the Principle That Deductions Must "Properly Reflect" Petitioner's Net Income.

Before the Circuit Court of Appeals respondent placed great emphasis upon his contention, in effect, that even if it should be determined that "liability" for the tax did accrue on December 31, 1943, rather than in 1944, and even if there were a valid lien for the tax on December 31, 1943, it was within his discretion to require the deduction therefor to be taken in 1944 rather than in the earlier year. Reference was made to the provisions of Sections 41 and 43 of the Internal Revenue Code as granting such discretion.

It is respectfully submitted that it is apparent that the Tax Court did not give more than passing consideration to this question. [See R. 56.] In fact, it did not directly cite Sections 41 and 43 at all; and the Circuit Court of Appeals merely adopted the Tax Court opinion. Reference is made to these sections at the present time only because it is assumed that the respondent will, following the pattern of his argument to the Circuit Court of Appeals, endeavor to support the decision of that court upon the ground of the discretion vested in him by these sections of the Code, notwithstanding it is evident that the decision was not in fact based upon that ground.

Section 41 is clearly inapplicable in the present case. It relates solely to the "method of accounting" to be employed. However, it is *admitted by the pleadings* in this case that the petitioner kept its books and filed its returns "on the accrual basis, *which basis clearly reflects its income.*" [R. 5, 14. Emphasis added.] There is,

therefore, no possible basis for applying that section here. As is stated in Regulations 111, Section 29.41-1:

> "* * * If the method of accounting regularly employed by him [taxpayer] in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for * * *."

As to the true extent of the Commissioner's discretion under Section 43, I.R.C., see *Security Flour Mills Co. v. Commissioner*, 321 U. S. 281. That case, although directly involving the question of the right of the taxpayer to *require* the Commissioner to allow a deduction in a certain year other than the year in which liability legally arose, clearly shows that Section 43 was not intended to *authorize or* require the Commissioner to take deductions out of the year in which they in fact legally accrue and put them in some other year upon the alleged ground that this is necessary in order "to clearly reflect income."

In any event, as to both Sections 41 and 43, the Commissioner's determination herein is clearly the result of his view that the specific accrual and lien provisions of the California Franchise Tax Act are *not controlling* for purposes of determining when "liability" for the tax thereby imposed accrued. See I.T. 3646, 1944 C.B. 104. This is not the exercise of "discretion" but merely the application of an entirely erroneous principle. No case holds that the Commissioner has "discretion" to determine accruals according to erroneous principles. As is said in the *Dixie Pine Products* case (320 U. S. 516, 518):

> * * * It has never been questioned that a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which *really accrues* in the taxable year. [Emphasis added.]

Neither Section 41 nor Section 43 in any way limits this statement. Regardless of what might be the extent of the Commissioner's discretion to determine the proper year for the accrual of liability *if* the tax statute did not contain express provisions identifying the accrual and lien date, it is clear that his discretion does not invest him with the power to shift the accrual date from the year in which liability for the tax in fact arose and became a lien on the property of the taxpayer to some undesignated time in 1944 under the guise of properly reflecting petitioner's net income.

Finally, it is submitted that if the discretion vested in the Commissioner by these sections had the effect contended for by him in the present case he would never lose a case involving accrual questions. Amongst the cases he has lost, however, and which necessarily demonstrate that the discretion which he claims is vested in him is not so broad or final as he now contends, see the following decisions:

Van Norman v. *Welch* (C.C.A. 1, 1944), 141 F. 2d 99, 103-104;

Commissioner v. Schock, Gusmer & Co. (C.C.A. 3, 1943), 137 F. 2d 750;

Allen v. Atlanta Stove Works (C.C.A. 5, 1943), 138 F. 2d 452;

Citizens Hotel Co. v. Commissioner (C.C.A. 5, 1943), 127 F. 2d 229;

Helvering v. Russian Finance & Construction Co. (C.C.A. 2, 1935), 77 F. (2d) 324, *supra;*

Baltimore Transfer Co., 8 T. C. 1.[8]

Durst Productions Corp., 8 T. C. 1326.

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[8]In an opinion by the same trial judge who rendered the decision in the present case.

The Commissioner would have been successful in every one of the above-cited cases if his discretion were as broad as he contends herein; but he lost them all.

To the extent, if any, that the decision of the Circuit Court of Appeals is based upon the ground that the Commissioner's disallowance of a deduction in 1943—the year in which, under the local law, the tax accrued and became a lien—was necessary in order properly to reflect petitioner's net income, such decision is in conflict with the *Security Flour Mills* case and the *Dixie Pine Products* case, *supra*, and with the decisions of other Circuit Courts of Appeals in the cases cited above.

Conclusion.

The decisions below should therefore be reversed.

Respectfully submitted,

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July 30, 1948.

APPENDIX.

Statutes, Regulations and Rulings Involved.

Internal Revenue Code:

Section 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

* * * * * * * * *

(c) *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year, * * *.

Section 41. General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

Section 43. Period for which Deductions and credits Taken.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

Section 48. Definitions.

When used in this chapter—

* * * * * * * * *

(c) "Paid or Incurred," "Paid or Accrued."—The terms "paid or incurred" and "paid or accrued" shall be

construed according to the method of accounting upon the basis of which the net income is computed under this Part.

Regulations 111:

Sec. 29.23(c)-1. Taxes.—(a) *In general.*—Subject to the exceptions stated in this section and sections 29.23(c)-2 and 29.23(c)-3, taxes imposed by the United States, any state or territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). * * *

Sec. 29.41-1. Computation of net income.—* * * The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-2. Bases of computation and changes in accounting methods.—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. * * *

Sec. 29.41-3. Methods of accounting.—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. * * *

Sec. 29.43-1. "Paid or incurred" and "paid or accrued."—(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. * * *

Section 29.43-2. When charges deductible.—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. * * *

California Bank and Corporation Franchise Tax Act (Calif. Stats. 1929, p. 19) as amended to and in effect on December 31, 1943:

Sec. 4. Tax on Corporations. * * *

* * * * * * * * *

(3) *Tax on Other Corporations.* With the exception of financial corporations, every corporation doing business within the limits of this State and not expressly exempted from taxation by the provisions of the Constitution of this State or by this act, shall annually pay to the State, for

the privilege of exercising its corporate franchises within this State, a tax according to or measured by its net income, to be computed, in the manner hereinafter provided, at the rate of 4 per centum upon the basis of its net income for the next preceding fiscal or calendar year. In any event, each such corporation shall pay annually to the State, for the said privilege, a minimum tax of twenty-five dollars ($25).

* * * * * * * * *

(5) *Minimum Tax.* Every corporation not otherwise taxed in pursuance of this section and not expressly exempted by the provisions of this act or the Constitution of this State shall pay annually to the State a tax of twenty-five dollars ($25).

* * * * * * * * *

(7) *Accrual date.* Taxes under this section and under Sections 1 and 2 of this act shall accrue on the last day of the "income year," as defined in Section 11 hereof.

Tax in Lieu of Other Taxes on General Franchises. Assessment of Special Franchises. Taxes under this section shall be in lieu of all ad valorem taxes and assessments of every kind and nature upon the general corporate franchises of the corporations taxable hereunder but shall not be in lieu of any taxes or assessments upon special franchises owned, held or used by said corporations.

* * *

Sec. 5. Definitions. The term "corporation," as herein used, shall include every corporation, other than a bank or banking association, and other than those expressly exempted from the tax by the provisions of this act or the Constitution of the State of California.

* * * * * * * * *

The term "doing business," as herein used, means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.

Sec. 11. Definitions. (a) The term "income year," as herein used, means the calendar year, or the fiscal year

ending during such calendar year, upon the basis of which the net income is computed herein. "Income year" includes, in the case of a return made for a fractional part of a year, the period for which such return is made.

(b) The term "taxable year," as herein used, means the calendar year, or the fiscal year ending during such calendar year, for which the tax is payable. A "taxable year" may constitute a period of 12 months or of less duration.

* * * * * * * * *

Sec. 13. Returns of Taxpayers. Computation of Tax in Case of Commencing Banks and Corporations, Dissolutions, Withdrawals, Cessation of Business and Corporate Reorganizations. (a) *Returns of Taxpayers.* Every bank and corporation subject to the tax imposed by this act shall, within two months and 15 days after the close of its income year, transmit to the commissioner a return in a form prescribed by him, specifying, for the income year, all such facts as he may by rule, or otherwise, require in order to carry out the provisions of this act.
* * *

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(j) *"Reorganization" Defined.* The term "reorganization" as used in this section means (1) a transfer by a bank or corporation of all or a substantial portion of its business or property to another bank or corporation if immediately after the transfer the transferor or its stockholders or both are in control of the bank or corporation to which the assets are transferred; or (2) a mere change in identity, form or place of organization however effected; or (3) a merger or consolidation; or (4) a distribution in liquidation by a bank or corporation of all or a substantial portion of its business or property to a bank or corporation stockholder. As used in this paragraph the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the bank or corporation.

(k) *Tax of Corporations Undergoing Dissolution or Withdrawal.* Any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any taxable year shall pay a tax hereunder only for the months of such taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by such proportionate part of the net income of the preceding income year as the number of months of the taxable year prior to the effective date of such dissolution or withdrawal bears to the entire preceding income year; provided, however, that in the case of any bank or corporation which is dissolved, or which withdraws from the State during any taxable year, the offset from the tax for the months of such taxable year prior to the effective date of such dissolution or withdrawal shall not exceed that proportion of the offset computed under Section 26 which the number of said months prior to the effective date of such dissolution or withdrawal bears to the number of months of the preceding income year; and provided further, that the taxes levied under this act shall not be subject to abatement or refund because of the cessation of business or corporate existence of any bank or corporation pursuant to a reorganization, consolidation, or merger. In any event, each such corporation shall pay a tax not subject to offset for such period in an amount equal to the minimum tax provided for in Section 4 of this act.

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(o) *Tax Liability for Short Taxable Years.* The tax liability imposed under this act shall attach whether a bank or corporation has a taxable year of 12 months or of less duration.

Sec. 29. Lien of Tax—Commissioner's Certificate. (a) The taxes imposed by this act and disclosed on the return shall constitute a lien upon the real property of the taxpayer, which lien shall have the same force, effect and priority as a judgment lien and shall attach on the last day of the "income year," * * *. * * * The lien provided for in this section shall remain until the taxes are paid or the property subject to the lien is sold for the

payment thereof, or until the lien is released or otherwise extinguished. * * *

(b) No decree of dissolution shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any such decree, or file any other document by which the term of existence of any taxpayer shall be reduced or terminated, nor shall the Secretary of State file any certificate of the surrender by a foreign corporation of its right to do intrastate business in this State unless the taxpayer obtains from the commissioner and files with said court, county clerk or Secretary of State as the case may be, a certificate to the effect the commissioner is satisfied from the available evidence that all taxes imposed by this act have been paid or are secured by bond, deposit or otherwise. Within 30 days after receiving a request for a certificate, the commissioner shall either issue the certificate or notify the person requesting the certificate of the amount of tax that must be paid or the amount of bond, deposit or other security that must be furnished as a condition of issuing the certificate. The issuance of the certificate shall not relieve the taxpayer or any individual, bank, or corporation from liability for any taxes, penalties, or interest imposed by this act.

California Corporation Tax Service:

Par. 5-313. Art. 13(m)-1. Dissolving or Withdrawing Corporations—Months Prior to Dissolution or Withdrawal.—Section 13(m) (k) of the Act provides that any bank or corporation which is dissolved and any foreign corporation which withdraws from the State during any taxable year shall pay a tax only for the months of such taxable year which precede the effective date of such dissolution or withdrawal, according to or measured by such proportionate part of the net income of the preceding income year as the number of months of the taxable year prior to the effective date of such dissolution or withdrawal bears to the entire preceding income year.

In the application of this provision, the month in which a corporation dissolves or withdraws shall be considered as a full month prior to dissolution or withdrawal, if dis-

solution or withdrawal occurs after the middle of such month. If dissolution or withdrawal occurs on or before the middle of the month, the month in which the dissolution or withdrawal occurs shall be disregarded. For example, suppose a corporation reporting on a calendar year basis dissolves or withdraws on June sixteenth of a particular year. The tax for the year in which the dissolution or withdrawal occurs will be based on one-half of the income for the preceding year, *i. e.*, on that portion of the income for the preceding year which six months, the number of months preceding dissolution, considering June as a full month bears to the number of months in the preceding year. If the corporation had dissolved or withdrawn during June, but prior to June sixteenth, the month of June would be disregarded. Thus, the tax for the year of dissolution or withdrawal would be based on five-twelfths of the income for the preceding year.

Par. 5-312a. Art. FT 13(k)-No. 1. Effective Date of Dissolution Under Section 13(k).—A taxpayer will be deemed to be dissolved, for purposes of Section 13(k)(1), when it has filed the certificate required by Section 403(c) of the Civil Code.

This regulation shall be applicable to all taxable years commencing after December 31, 1938. For prior taxable years, such dissolution will be deemed to have occurred when the taxpayer distributed all of its assets after the stockholders voted for or consented to such distribution pursuant to Section 400 of the Civil Code.

Authority for this regulation is contained in the following sections of the Bank and Corporation Franchise Tax Act: 13(k)(1), 22, 22.1 and 29. (*As issued December 27, 1945.*)

Par. 8-053. Art. 29-1. Dissolution or Withdrawal of Corporations.—Section 29 provides that no decree of dissolution shall be made and entered by any court, nor shall the county clerk of any county or the Secretary of State file any such decree, or file any other document by which the term of existence of any taxpayer shall be reduced

or terminated, nor shall the Secretary of State file any certificate of the surrender by a foreign corporation of its right to do intrastate business in this State until the tax, penalties, and interest shall have been paid.

To facilitate the dissolution and withdrawal of banks and corporations, the Commissioner will issue a certificate to the effect that all taxes, penalties and interest imposed by the Act upon a bank or corporation desiring to dissolve or withdraw have been paid provided the following requirements are met:

1. All returns required under the Act must be filed, and all taxes, penalties and interest for taxable years prior to the year in which dissolution or withdrawal is to occur must be paid.

2. Except in the case of banks, a tax of at least $25 for the taxable year in which dissolution or withdrawal is to occur, plus any penalties or interest that may have accrued in connection therewith, must be paid. If the bank or corporation has not engaged in any business activities in this State since the beginning of the year in which dissolution or withdrawal is to occur, and does not intend to engage in any such activities prior to dissolution or withdrawal, and if an affidavit to the foregoing effect signed under oath by one of the officers or other duly authorized representative of the bank or corporation is filed, no further taxes need be paid.

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(*Adopted October* 5, 1937.)